Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

MAY 3 0 1996

In the Matter of	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)))	CC Docket No. 96-98

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REPLY COMMENTS OF U S WEST, INC.

Robert B. McKenna
James T. Hannon
Suite 700
1020 19th Street, N.W.
Washington, DC 20036
(303) 672-2861

Attorneys for

U S WEST, INC.

Of Counsel,
Dan L. Poole

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SUMMARY

This docket seeks to establish the basic ground rules for interconnection pursuant to the Telecommunications Act of 1996. In its initial comments, U S WEST, Inc. sought to establish some fundamental principles which would guide negotiations for interconnection agreements under the 1996 Act, and which would best be suited for the transition towards a telecommunications marketplace based on true competition. We pointed out that, based on initial demands for negotiation and preliminary ex parte presentations, it seemed that some industry participants (led by AT&T and MCI) seemed to view the new 1996 Act as a license to confiscate incumbent LEC assets and use those confiscated assets to destroy the remaining competition.

This development would occur if a regulatory structure were put in place which required that network elements or wholesale prices be established in a manner which would not permit recovery of the true economic costs of the service or facility being provided. Not only would such a regulatory scenario work toward destruction of the existing telecommunications infrastructure (and cause a compensible "taking" of incumbent LEC property), it would stifle the development of true facilities-based competition in direct contravention of the 1996 Act itself.

In their initial comments, AT&T and MCI have documented that U S WEST's worst fears were not exaggerated. AT&T and MCI demand in their initial comments that incumbent LEC networks be unbundled well below the level where it would be economical to do so, yet they do not want to pay for either the costs of

that unbundling or the efficiency losses which such unbundling would occasion. Moreover, they have devised a costing theory which would prevent incumbent LECs from even recovering the cost of their unbundled investment, or from receiving sufficient revenue to permit them to continue to run their businesses. AT&T even posits a theory which would require incumbent LECs to construct free trunking for AT&T whenever the incumbent LEC did not have enough real estate available to donate to AT&T (at AT&T's well below cost price). AT&T and MCI base much of their analysis of their demanded prices on a secret document (the so-called "Hatfield Model") which they refuse to permit anyone to see. Both MCI and AT&T demand that massive discounts for "wholesale" services be given without making any of the commitments as to volume or term which normally characterize wholesale contracting. AT&T is adamant on its right to obtain all of these services and facilities at highly discounted prices without even telling the incumbent LECs what, where and when it actually intends to purchase.

The AT&T/MCI position indeed reads like a nightmare devised by Franz Kafka -- an analogy which becomes more apt when it is considered that the Department of Justice supports some of the more bizarre AT&T theories. If the AT&T/MCI premise is adopted -- or even given serious credence -- the entire pro-competitive thrust of the new 1996 Act will have been thwarted. In these reply comments, U S WEST sets forth some additional detail on costing and unbundling which must guide negotiations under the 1996 Act.

In addition, U S WEST attaches an affidavit of Robert Harris, a renowned economist who has studied the transition to competitive markets in detail. Professor Harris provides further detail on the prerequisites for a competitive market (as he did in collaboration with Professor Dennis Yao in U S WEST's opening comments), focusing on regulatory anomalies and proper TSLRIC pricing. Professor Harris also verifies the fundamental conclusion that adoption of the AT&T/MCI position would effectuate a constitutional taking of the property of incumbent LECs.

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U S WEST, Inc. ("U S WEST"), hereby files its reply comments in the first phase of the above-captioned docket.[1]

I. INTRODUCTION

In this docket, the Federal Communications Commission ("Commission") seeks to implement the interconnection provisions of the new Telecommunications Act. If the Commission remains true to sound economics and Congressional intent, the new pro-competitive policies should lead to increased competition, deployment of new and innovative telecommunications facilities and services, a sounder economy based on a modern telecommunications infrastructure, and increased telecommunications job opportunities.

Some commenting parties (led by AT&T Corp. ("AT&T") and MCI Telecommunications Corporation ("MCI"))[2] seek, through their advocacy, to prevent

[1] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Notice of Proposed Rulemaking, FCC 96-182, rel. Apr. 19, 1996 ("Notice").

realization of these goals. Instead, they promote a regulatory regime which would confiscate incumbent local exchange carriers' ("LEC") property and utilize that property to subsidize their own competitive agendas. Should such advocacy ultimately be reflected in Commission policy, efforts by those who would build new competitive telecommunication facilities to compete successfully against AT&T, MCI and the LECs would be materially thwarted. Stated simply, if AT&T's and MCI's position in their initial comments were to be adopted, the Nation's telecommunication infrastructure could be wrecked, and LEC assets parceled out to other carriers. Under such a scenario, the government would be liable for billions of dollars in "takings" damages to existing incumbent LECs, and true competition would not develop. These issues are discussed in the following sections.

AT&T has provided the Commission with a clear example of how far it is willing to go in its attempts to deceive when, in its comments, it mischaracterizes its write down of analog equipment. In arguing that interconnection prices should not permit recovery of LEC investments, AT&T observes that competitive companies often write off non-productive assets. Indeed, citing to a comment by Sprint Corporation in an unrelated docket, AT&T states that when it replaced its analog plant with digital plant it neither sought nor needed help from regulators in recognizing that

[2] Comments of AT&T Corp., filed herein May 16, 1996; Comments of MCI Telecommunications Corporation, filed herein May 16, 1996. In these Reply Comments we often utilize "AT&T" generically to describe a common position.

investment, it claims:[3] "[t]he resulting asset writedown was borne by shareholders, and an 'entitlement' due to competition was neither requested from regulators nor expected."[4]

Revisionist history is a generous way of describing AT&T's assertion. In point of fact, AT&T not only requested special relief from regulators when it replaced its analog plant, it received a material regulatory benefit. In 1988, AT&T wrote down $6 billion in analog plant in response to market forces. This write-down was recorded on AT&T's financial books only; the amount remained on AT&T's regulated books. In 1989, AT&T filed with the Commission to use financial lives for this plant on its regulated books. The Commission granted AT&T what amounted to a $1 billion increase in annual depreciation expense (a 50% increase).[5] Had AT&T not been permitted to depreciate its "write off" analog equipment in this manner, AT&T's rate of return during its initial price cap year would have skyrocketed to over 20%, rather than the 11.5% return it actually reported.

AT&T's pronouncements as to its own willingness to forego recovering its regulated investments is simply not true. AT&T's entire advocacy in this docket with respect to incumbent LECs should be reviewed with skepticism.

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[3] AT&T at 71 n.105.

[4] Id.

[5] See In the Matter of The Modification of the Commission's Depreciation Prescription Practices As Applied to AT&T and The Prescription of Revised AT&T Depreciation Rates, Memorandum Opinion and Order, 4 FCC Rcd. 8567 (1989); The Matter of The Prescription Percentages of Depreciation pursuant to the Communications Act of 1934, as amended, for American Telephone and Telegraph Company, Order, 5 FCC Rcd. 660 (1990).

II. GOOD FAITH NEGOTIATIONS
Notice Section II.B.1.

Various commenting parties allege that U S WEST, during the several months immediately following passage of the Act, did not negotiate interconnection arrangements in "good faith."[6] From these allegations, these parties generally conclude that U S WEST must hold monopoly power. On that account, they urge the Commission to promulgate stringent federal rules, along the lines demanded by the commentors, in order to coerce good faith negotiations.[7] Several brief observations are in order.

First, while AT&T is the preeminent leader in complaining about the failure of incumbent LECs to negotiate in good faith, it is AT&T which insists on the right to "negotiate" prices, term and condition of interconnection, network elements and wholesale services, absent any willingness to disclose or commit to anything specific in the way of an actual purchase. It defies belief, not to mention generally expected commercial negotiating behavior, that AT&T can characterize its unilateral demands for unspecified services as "good faith" negotiations while labeling anything other than incumbent LEC acquiesce as "bad faith."

It is obvious that the first element of true negotiation is a *bona fide* request by an interconnector for services or facilities. No incumbent LEC can be expected to engage in meaningful negotiation about unbundled network elements (e.g., the scope of unbundling or price), interconnection or wholesale prices, unless and until

[6] See, e.g., AT&T at 86-87; MCI at 14-15.

[7] See, e.g., AT&T at 86-88; MCI at 10-58.

the interconnector reveals what it really intends to purchase. AT&T steadfastly refuses to reveal any of this information.

The Commission should clarify that some kind of *bona fide* request policy may reasonably be required by incumbent LECs as a precondition to interconnection negotiations. Such a rule is especially important in those circumstances where an entity is requesting the unbundling of network elements. Because the technical feasibility of unbundling a particular network element will often depend on the specific commitments which an interconnector is willing to make, any request for a particular network element must be backed up by a *bona fide* request. If an incumbent LEC cannot determine what an interconnector wants in terms of quantity, location, and terms of network elements, it will not be possible to evaluate a proper price or to negotiate reasonably for the network elements in question.

Second, several commentors have asserted that an incumbent LEC may not withdraw a service if an interconnector wishes to purchase that service. As a specific example, commentors point to U S WEST's announced withdrawal of its Centrex product.[8] Essentially, the advocacy argues that U S WEST may not, in "good faith," withdraw a product from the market if someone else desires to resell that product. This view ignores economic reality. In a competitive marketplace, products will be withdrawn and replaced routinely.

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[8] See, e.g., AT&T at 76 n.110; MCI at 87-88.

U S WEST's withdrawal of the Centrex product was a reasoned business decision. The old Centrex service had become, in U S WEST's business judgment, not suitable for the new competitive marketplace.

Under the Act, negotiations must be based on the economic realities and business discipline which the Act itself introduces into the market. These economic realities include the right and ability of an incumbent LEC to reconfigure its services to reflect rational economic phenomena. Such phenomena would include the right to withdraw, reconfigure or introduce a service based on economic conditions.

Third, the unknown factor in any interconnection negotiation will necessarily be the arbitration process. The Act clearly contemplates that arbitration may be necessary, even in the context of "good faith" negotiations. Given that no party is required to forego advancing an advantageous bargaining position, the failure to reach accord and the business decision to proceed to arbitration cannot be considered a "bad faith" position. Indeed, even with both parties negotiating in good faith fully intending to reach an agreement, arbitration may still be necessary. Congress anticipated that parties might not agree and incorporated an arbitration process to address these situations. There is no reason to assume that arbitration would be necessary only if a party was bargaining in "bad faith."

III. COSTS AND PRICES FOR INTERCONNECTION MUST REFLECT ECONOMIC REALITY Notice Section II.B.2.

A. The Pricing Structure Advocated By AT&T And MCI Would Be Confiscatory Notice Section II.B.2.

It is the position of AT&T that it has the right, under the Act, to have the Commission chop up incumbent LECs and give the pieces to AT&T. This is because AT&T espouses a costing theory which would prevent profitable LEC operations.[9] As has been pointed out, no costing or pricing theory can be lawful or make economic sense unless it allows incumbent LECs to operate their businesses, including recovering their investment, at a profit. While AT&T utters phrases such as "[Total Service Long Run Incremental Cost] TSLRIC [as AT&T defines it] is fully compensatory,"[10] a review of the totality of AT&T's position conclusively demonstrates that AT&T is interested in confiscation, not equity, lawfulness or competition.

We start with the indisputable proposition that incumbent LEC's current costs are based on real costs; not, as AT&T and others imply, some type of phantasmagorical cost structure which will go away if AT&T has its way. U S WEST's interstate rate of return for 1995 was 11.61%. Clearly, U S WEST has been earning a modest return on its investment. Neither U S WEST's investment nor operational costs will disappear under AT&T's proposal. Only the revenue needed to support this investment and business will be absent.

AT&T's advocates the following costing principles:[11]

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[9] AT&T's theory works only if applied solely to those services and facilities purchased by AT&T -- in other words, if AT&T's services are cross-subsidized.

[10] AT&T at 49, 70.

[11] Between carrier access and retail services, all U S WEST's carrier services are covered.

Network element prices (access – interstate and intrastate).

- U S WEST may price to recover "forward looking costs" only -- not plant already in service, even though this is the "plant to be unbundled".[12]
- No recovery of unbundling costs.[13]
- Costs associated with inefficiencies of unbundling may not be recognized.[14]
- U S WEST's own "forward looking costs" are not the relevant costs -- U S WEST must use theoretical costs.[15]
- Discount from current interstate access rates -- 87.5%.
- Discount from current intrastate access rates -- presumably the same.
- No AT&T purchase, volume, term or location commitments.
- Free transport where U S WEST real estate not available for AT&T's occupation.[16]

Wholesale price (Retail – end user-services)

- 44% discount from existing retail rates.[17]
- Cost of providing wholesale services cannot be recovered.[18]
- No term, volume, commitments.[19]

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[12] AT&T at 55-56. See also Telecommunications Carriers for Competition ("TCC"), filed herein May 16, 1996 at 17; MCI at 61-72 and Attachment 1 at 14.

[13] AT&T at 61 n.91. See also TCC at 18-19; MCI at 73-77.

[14] AT&T at 63-64. See also TCC at 25; MCI at 29-38.

[15] AT&T at 46-54. See also TCC at 22-24; MCI, Attachment 1 at 16-31.

[16] AT&T at 41-42.

[17] AT&T at 83-86. See also MCI at 89 and Attachment 2 at 11-12 (and graph and table).

[18] AT&T at 84. See also TCC at 45-47; MCI at 89-94 and Attachment 2 at 3-10.

[19] AT&T at 82-83. See also MCI at 94.

- 44% discount from promotional prices.[20]
- 44% discount from wholesale rates sold to large customers.[21]

The math is in no sense complicated. No company can survive in an environment such as is advocated by AT&T.

The bottom line is that, as long as one can ignore the existence of real, actual total corporate costs, individual/service costs can be defined as anything some self-professed expert proclaims. AT&T and MCI argue for costs analyses which, in the context of the actual operations of U S WEST, would be tantamount to an actual confiscation of its property. Indeed, as is emphasized in Professor Robert G. Harris' Reply Affidavit, following AT&T's lead would prevent U S WEST from recovering its operating costs and earning a reasonable return on its investment -- the classic definition of confiscatory ratemaking.[22]

B. AT&T's Approach Would Stifle Construction Of New Telecommunications Facilities And Development Of True Competition Notice Section II.B.2.

Harris and Yao explained in detail how the pricing of unbundled network elements or wholesale services below true economic cost would work to disrupt facilities-based competition, inhibit investment in new telecommunications

[20] AT&T at 82-83. See also TCC at 43; MCI, Attachment 2 at 6.

[21] AT&T at 83-84. See also MCI at 90-94 and Attachment 2, generally.

[22] See Reply Affidavit of Robert G. Harris, appended hereto as Attachment A, at 1, 12-16 ("Harris Reply Affidavit").

facilities, and lead to market dominance by AT&T (and possibly MCI).[23] Initial comments in this docket merit additional comment in this area.

First, not surprisingly, incumbent LECs are not the only entities troubled by the AT&T position that competition can ascend on the backs of confiscated LEC facilities. Those entities who actually plan to provide local exchange competition likewise perceive the danger to true competition which the AT&T approach would represent, particularly in the area of resale.

The National Cable Television Association (or "NCTA"), for example, whose members can be expected to provide a significant amount of facilities-based competition in local exchanges, notes Congress' "strong and clear preference for facilities-based competition"[24] and warns against below-cost pricing as a deterrent to that goal.[25] NCTA's affidavit of Bruce M. Owen strongly advises against requiring excessive resale discounts, observing: "Indeed, an excessive resale discount may be equivalent in its effects on facilities-based competition to predatory pricing by the [incumbent LEC]."[26] Similar warnings are issued by a variety of commenting parties whose plans

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[23] U S WEST Comments, Exhibit A at 18-27, 29-35, 37-39 (or "Harris and Yao Affidavit").

[24] Comments of the National Cable Television Association, Inc., filed herein May 16, 1996 at 26.

[25] Id. at 26-30.

[26] Id., Attachment 1, Declaration of Bruce M. Owen at 12.

to introduce facilities-based competition would be threatened by acceptance of AT&T's pricing and costing proposals.[27]

Second, U S WEST and other incumbent LECs are equally constrained in their abilities to make intelligent economic decisions about their own futures. If regulations governing the pricing of network elements or wholesale services make investment in facilities utilized to provide these services uneconomical, incumbent LECs will be forced to forego investments in their own networks.

C. Depreciation Expenses Are A Critical Component Of Any Company's Costs Of Operation Notice Section II.B.2.

Some interconnectors (including MCI) take the position that depreciation expenses are not a legitimate cost of doing business chargeable to interconnectors.[28] Others, (including AT&T), concede the legitimacy of some depreciation expense, but calculate "forward looking" costs in such a manner that practically all depreciation expense is excluded.[29] Several observations about depreciation expenses are appropriate.

[27] See Comments of MFS Communications Company, Inc. ("MFS"), filed herein May 16, 1996 at 4, 40; Comments of Tele-Communications, Inc. ("TCI"), filed herein May 16, 1996 at 3-4, 7; Comments of Time Warner Communications Holdings, Inc., ("Time Warner") at 13, 48-49, 65; Comments of Continental Cablevision, Inc. ("Continental"), filed herein May 16, 1996 at 2, 5, 22; Comments of Comcast Corporation ("Comcast"), filed herein May 16, 1996 at 20-21.

[28] See, e.g., MCI at 74-75 and Attachment 1 at 38-39.

[29] AT&T at 55-56. See also TCC at 17.

First, there is no more certain way in which to suppress investment than by not allowing for reasonable treatment of depreciation expenses. Depreciation is basically the engine by which investment is recovered.[30]

Second, as Harris points out in his Reply Affidavit, proper treatment of depreciation expense results in a much more accurate TSLRIC calculation.[31] Many of AT&T's and MCI's erroneous costing figures are based on regulatory, rather than business-driven, depreciation decisions. The former cannot and will not continue in a competitive market.[32] Simply stated, proper depreciation results in a fundamental symmetry between embedded costs and forward-looking costs. Further skewing the establishment of proper depreciation practices would serve to continue and exacerbate what AT&T and MCI claim is the disparity between actual LEC costs and "forward-looking costs," as AT&T and MCI defines them. Realistic depreciation should, in a matter of years, moot much of AT&T's and MCI's argument.

D. If AT&T Can Construct A Network For What It Claims Are Incumbent LEC TSLRIC Costs, AT&T Should Be Required To Construct LEC Networks At That Price
Notice Section II.B.2.

The emptiness of AT&T's cost advocacy can be illustrated by the following contradictory premises espoused by AT&T:

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[30] The Supreme Court itself has recognized the importance of depreciation expense in the context of a regulated industry. See, e.g., Louisiana Public Service Commission v. FCC, 476 U.S. 355, 364-65 (1986).

[31] See Harris Reply Affidavit at 5-7.

[32] See id. at 5-6, showing U S WEST's regulated depreciation lives being about twice as long as the lives of identical plant of AT&T and others.

- AT&T argues that it would be extremely expensive for it to construct LEC network facilities -- $29 billion to duplicate 20% of the incumbent LEC access lines in the most densely populated areas.[33] AT&T claims that its investment cost amounts to a TSLRIC of approximately $1,200 per line.

- Hence, AT&T wants incumbent LECs to construct AT&T's LEC network for it.[34]

- But AT&T does not want to pay incumbent LECs a price for network service which permits recovery of LEC investment. Indeed, it does not even want LECs to cover their own costs in pricing services.[35]

- The price which AT&T desires to pay incumbent LECs is far less than AT&T contends it would pay to construct the identical facilities itself.

Something is obviously wrong with this picture.

AT&T seeks to foist costs of network construction on incumbent LECs on the basis that it cannot afford to construct the relevant networks itself. At the same time, AT&T complains that incumbent LECs operate so inefficiently that they should not be permitted to recover their construction costs. On a simple sincerity test, AT&T should be required to construct networks and unbundled loops for incumbent LECs, and charge prices calculated based on AT&T's TSLRIC analysis.

E. AT&T Does Not Price According To Its Own TSLRIC Pricing Principles Notice Section II.B.2.

For the most part, AT&T and MCI base their demands in their initial comments on their perceived statutory rights,[36] buttressed by an ambiguous sense

[33] AT&T at 75 n.108.

[34] Id. at 41-42.

[35] AT&T at 45-73. See also MCI at 89-94 and Attachment 2 at 3-10.

[36] AT&T at 32. See also MCI at 59-63, 77-83.

that incumbent LECs are anticompetitive monopolies.[37] However, AT&T and MCI also assert that the pricing principles which they propose are those which would naturally be charged in a competitive market.[38] In other words, AT&T proclaims that it is really not demanding that incumbent LECs price at any different levels than would be the case in a fully competitive market.[39]

Surprisingly, AT&T's own prices and practices do not even remotely substantiate AT&T's position. Were AT&T's position on TSLRIC pricing true, AT&T's prices in the competitive interexchange market would be reflective of AT&T's own TSLRIC costs. However, such is not the case. Quite to the contrary. AT&T's general tariff prices are approximately more than 70% higher than the prices it charges for the same services to its premier customers under its Tariff 12 pricing structure.[40] Were AT&T's prices based on any tested version of meaningful and realistic TSLRIC costs, there would be no room for this vast price differential.[41] AT&T's own pricing practices in a competitive market do not follow the pricing theory it espouses in its comments, and its arguments that a competitive market would demand prices based on AT&T's TSLRIC theory is simply false.

F. AT&T's Claim That U S WEST May Not Even Use Its Own Costs Is Misplaced Notice Section II.B.2.

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[37] AT&T at 16; MCI at 2, 75-77, 86-87 and Attachment 1 at 37.

[38] AT&T at 48-54; MCI at 59-72.

[39] AT&T at 48-54. See also MCI at 59-68.

[40] Harris Reply Affidavit at 12-13.

[41] Id.

As sort of a final insult, AT&T sums up its costing/pricing argument by claiming that, even under AT&T's own TSLRIC theory, U S WEST may not base interconnection prices on its own costs. AT&T's logic stems from its assertion that U S WEST's costs are too high.[42]

AT&T argues that, because U S WEST is and has been "monopolistic," it has routinely "goldplated" its network with unnecessary construction,[43] amassing a huge reserve of unnecessary investments that AT&T does not want to pay for.[44] Hence, AT&T proclaims that U S WEST's costs ought to be based on what Professor Hatfield thinks they should be, rather than on what they are.

Several problems exist with this argument.

First, even if AT&T's argument made economic sense, there is no room to construe the statutory language "cost plus a reasonable profit" to incorporate the notion "Hatfield Potential Costs Plus Hatfield Theoretical Profit" ("HPCPHTP"). A reasonable profit must be based on actual costs; or, it is not a profit at all.

Second, most of the "monopolistic" behavior in which incumbent LECs are alleged to have engaged by AT&T is not monopolistic behavior at all.[45] To the contrary, particularly in pricing and subsidization practices, this behavior simply

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[42] AT&T at 45-74. See also MCI at 59-68.

[43] AT&T at 66. See also MCI at 73-75 and Attachment 1 at 40-43.

[44] AT&T at 59. See also MCI, Attachment 1 at 40-43.

[45] The Notice occasionally falls prey to this notion. For example, the Notice cites the "99.7 percent share of the local market as measured by revenues" held by incumbent LECs (Notice ¶ 6). Of course, if the market were defined to include everything which was included in the market in 1980. (e.g., CPE, inside wire, some enhanced services), this share would be much lower.

responds to the demands of regulators in the confusing environment which marks the transition from monopoly to competition. As the Harris and Yao Affidavit succinctly observed, the major barrier to competition in the telecommunications market today is not posed by incumbent LECs. Rather, it is posed by regulators who refuse to accept the realities of competition.[46]

Third, it is impossible to argue honestly that U S WEST has "goldplated" its network when state regulators are almost unanimous in contending that U S WEST has not invested enough in that very same network.. U S WEST is receiving formal pressure from regulators in thirteen of its fourteen states to increase its network investment. Indeed, MCI recently complained to the Oregon Public Utilities Commission about U S WEST's inadequate expenditures in "expanding physical plant, upgrading aging systems, providing necessary employee training, and maintaining the appropriate employment levels."[47]

While we submit that the Act has circumscribed a state's right to demand LEC investment on a going-forward basis,[48] it is impossible to separate U S WEST's existing network from those regulatory imperatives that guided its construction. If U S WEST's network were "goldplated," such "goldplating" would be a direct result of governmental directives. And certainly, MCI's demands for yet additional

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[46] U S WEST Comments, Exhibit A at 8-10, 18-20.

[47] Letter from Dick Powell, MCI, to Honorable Joan Smith, U S WEST Regional Oversight Committee dated Oct. 20, 1995.

[48] Any such mandated construction would need to be situated so as to guarantee cost recovery.

construction diminishes its argument that U S WEST has invested too much in its network.

Finally, if U S WEST's networks really are as inefficient, bedraggled and "goldplated" as AT&T and others claim,[49] those same networks would present U S WEST with a tremendous liability, not a source of competitive advantage. AT&T's claim that the LECs' embedded networks are dramatically overpriced is inconsistent with the argument that those same networks are the source of monopoly power.

G. Unbundling Will Quickly Eliminate The Need For Any Cost Regulation Notice Section II.B.2.

MFS makes an observation in its comments which is both accurate and interesting. MFS notes that network unbundling, because it provides opportunities to bypass uneconomically-priced elements, could well moot much of the controversy about the pricing of interconnection services in this docket.[50] In other words, the simple fact of unbundling network elements prevents irrational pricing by increasing competitive opportunities to arbitrage any unreasonable pricing disparities.

This position is not too dissimilar to U S WEST's position that the Commission should focus on call termination and equal interconnection in developing long-term rules for the competitive marketplace.[51] That is, if the

[49] AT&T at 58. See also MCI at 5, 63, 73-75 and Attachment 1 at 40-43.

[50] MFS at 58-59.

[51] U S WEST Comments at 11-12 and Exhibit A at 15-17.

Commission focuses its attention on call termination and interconnection practices, market forces will resolve most of the costing issues addressed in this docket.

H. Common And Shared Switch Costs Notice Section II.B.2.

AT&T and MCI (joined, inexplicably, by the Department of Justice)[52] appear to be operating under the mistaken assumption that incumbent LECs are required to unbundle their networks to such an extreme degree that they will be nothing more than suppliers of network components to other telecommunications carriers. Of course, these parties also assert that incumbent LECs must supply these components at incremental cost with little or no allowance for common and shared costs.[53]

The magnitude of common and shared costs in the telecommunications industry is illustrated by the examination of switch costs in the comments of the University of Florida, "Telecommunications Industry Analysis Project."[54] The University of Florida's switch study demonstrates that common switch costs range from 90% for small switches to 75% for large switches.[55] These common costs[56] are

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[52] AT&T at 15-34; MCI at 10-40; Comments of the United States Department of Justice, filed herein May 16, 1996 at 19-21.

[53] In some cases, these parties go so far as to claim that the price of incumbent LEC components should be zero if there is excess capacity. (See MFS' discussion of physical collocation at 31-32).

[54] Comments of University of Florida College of Business Administration, filed herein May 14, 1996.

[55] Id. Appendix 1 at 16.

further broken down into costs that are: 1) common to line side; 2) common to trunkside; and 3) common to all switched services. Clearly, any approach to establishing the prices for switched services which focuses on incremental cost pricing will ignore the vast majority of switch costs.

I. Costs Of Unbundling
Notice Section II.B.2.

A number of commentors continue to refuse to recognize that unbundling may itself cause significant costs to be incurred, which must be recovered from the cost-causing entity. As U S WEST pointed out in its initial comments, there are significant costs associated with unbundling and interconnection, including implementation of additional interfaces and equipment and loss of operational efficiencies.[57] AT&T's request for a sub-loop unbundling at the feeder-distribution interface ("FDI") illustrates some of these expenses.

In today's environment, U S WEST has a single cross-connect cabinet at the FDI, as shown in Figure 1 (attached hereto). If U S WEST is required to unbundle at the FDI and other entrants elect to provide their own feeder cable, additional cross-connect cabinets (or a much larger and more complex combined cross-connect cabinet) will be required. As Figure 1 demonstrates, not only will each individual carrier terminating its feeder cable require a cross-connect cabinet, but a shared

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[56] The University of Florida does not distinguish between common and shared costs in its study. Dr. Harris distinguishes between shared costs which "are incurred for facilities and resources used in the production of two or more services" and common costs which "are incurred through facilities and resources used in the production of all the LECs services." Harris and Yao Affidavit at 18.

[57] See U S WEST Comments at 47-58.